CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORE APARTMENT REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous core apartment real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Core Apartment Real Estate Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest risk adjusted total rate of return possible is the strategic objective of the Portfolio. This objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Core Apartment Real Estate Portfolio shall be managed to accomplish the following:

A. Provide diversification;

B. Preserve investment capital;

C. Generate attractive risk-adjusted rates of return for the System;

D. Provide a hedge against inflation;

E. Provide stable cash flow from operations;

F. Provide appreciation potential; and

G. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

A. Exceed (after fees) a minimum target real rate of return of 5.0%; and

B. Exceed (before fees) the National Council of Real Estate Investment Fiduciaries Index ("the NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

Subject to the Statement of Investment Policy for Equity Real Estate, the following is the current asset allocation range for the Core Apartment Real Estate Portfolio as a percent of the total Equity Real Estate Portfolio:

	Range
Core Apartment Real Estate Portfolio	10 - 35%

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable time frame.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Diversification

The Portfolio shall reduce risk through appropriate diversification. Diversification shall occur primarily by geography and investment strategy, as outlined below.

1. Diversification by Geography

The Portfolio shall be comprised primarily of investments in the United States. The Portfolio shall contribute to the overall geographic diversification objectives of the Core Real Estate Portfolio as specified in the Statement of Investment Policy for Equity Real Estate.

2. Diversification by Strategy

   The System shall employ a broad range of strategies for apartment property investments. The allocation ranges established for each of the recommended strategies are a percentage of the Core Apartment Real Estate Portfolio listed below. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Existing Stabilized "Class A" Properties	30 -100%
Existing Stabilized "Class B" Properties	0 - 50%
Existing Value-Added Properties	0 - 10%
Speculative Development	0 - 10%
Land	0 - 5%

   The Senior Investment Officer of Real Estate may allow a specific core property sector to exceed 10% Speculative Development level as long as the **overall** Core Portfolio Speculative Development level **does not** exceed 10%.

3. From time to time, the actual allocations of various geographic sectors and investment strategies may fall out of the ranges prescribed by the Policy. In these instances, the System shall implement adjustments correcting the actual allocations so they comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the investment returns for the System, is considered a reasonable time frame.

4. The Investment Manager may utilize a forward commitment defined as a Presale Investment. A Presale property may be a Class A or Class B Property that is to be constructed (or is under construction) which the Investment Manager contracts to purchase subject to an appropriate criteria such as, completion of construction and receipt of Certificates of Occupancy for all of the apartment units, and or, a minimum lease up requirement.

B. Investment Objectives and Criteria

1. Existing Stabilized "Class A" Properties

   a. "Class A" shall refer to properties of the highest grade based on location, age, and quality of construction and amenities.

   b. Investment objective is to generate cash flow returns with appreciation potential.

   c. Investment Criteria

      (1) Properties shall be newly constructed or substantially renovated within the past 15 years;

      (2) At least 80% occupancy upon acquisition;

      (3) Minimum 150 units size;

      (4) High quality construction;

      (5) A full range of high quality amenities;

      (6) Location shall feature proximity to major employment areas and transportation routes, retail services and other commercial and community services;

      (7) Rental rates shall fall within top 25% of sub-market;

      (8) Each property shall produce a minimum five-year real IRR (after fees) of 5%;

      (9) Each property shall produce an appropriate risk adjusted return; and

      (10) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

2. Existing Stabilized "Class B" Properties

   a. "Class B" shall refer to assets of a lesser grade compared to "Class A" properties based on location, age, and quality of construction and amenities.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) Properties shall be newly constructed or substantially renovated within the past 20 years;

(2) At least 85% occupancy upon acquisition, with stable history;

(3) Minimum 150 units size;

(4) Quality construction and design, preferably of brick or other more durable materials;

(5) Properties shall feature a range of amenities competitive within this market segment. Typically, fewer amenities than “Class A” apartments;

(6) Locations will feature proximity to major employment areas and transportation routes, retail services, and other commercial and community services;

(7) Rental rates shall fall within the top 50% of sub-market;

(8) Each property shall produce a minimum five-year real IRR (after fees) of 5.5%;

(9) Each property shall produce an appropriate risk-adjusted return; and

(10) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

3. Value-added Properties

a. “Value-added” shall refer to existing properties acquired with the intention of redeveloping, re-leasing or repositioning the properties in some manner to yield higher total returns.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) Properties shall be newly constructed or shall have been substantially renovated within the past 25 years;

(2) Occupancy requirements shall be subject to scope of redevelopment;

(3) Minimum 150 units size;

(4) Properties shall feature a range of amenities competitive within this market segment after completion of redevelopment. Typically, fewer amenities than Class "A" apartments;

(5) Locations shall feature proximity to major employment areas and transportation routes, retail services, and other commercial and community services;

(6) Rental rates shall fall within the top 50% of sub-market after renovation;

(7) Each property shall produce a minimum five-year real IRR (after fees) of 6.5%;

(8) Each property shall produce an appropriate risk-adjusted return; and

(9) Additionally, new acquisitions shall require acceptable initial stabilized cash.

a. Additional Criteria

(1) Value-added properties must be of quality design and construction that can be upgraded to be competitive with newer apartment properties;

(2) Total expenditures to reposition apartment properties should not exceed 30% of replacement cost;

(3) Replacement cost is defined as the estimated cost, to construct at current prices a building with amenities equivalent to the existing buildings using modern materials and current standards, designs, and layouts. The replacement cost includes all direct, indirect, and land costs; and

(4) The System shall acquire properties at substantial discounts to replacement cost.

4. Speculative Development

a. Investment objective is to generate cash flow returns with appreciation potential.

b. Investment Criteria

(1) Age - new construction;

(2) Occupancy - initially none. Developer may have earn-out tied to lease-up when appropriate;

(3) Size - minimum 150 units;

(4) Amenities - range of amenities to be competitive in local market;

(5) Location - proximity to major employment areas and transportation routes;

(6) Rental rates - top 40% of sub-market upon initial stabilization;

(7) Each property shall produce a minimum five-year real IRR of 7.5% (after fees);

(8) Each property shall produce an appropriate risk-adjusted return; and

(9) Additionally, development projects shall require an acceptable initial stabilized cash return.

a. Additional Criteria

(1) Development should only be in markets, which exhibit favorable supply and demand conditions. Markets shall have favorable demographics, limited sites for new development, and a limited supply of investment capital for new construction;

(2) Development shall meet guidelines set forth in the Statement of Investment Policy for Real Estate Development and the Statement of Investment Policy for Equity Real Estate Joint Ventures;

(3) Development activities shall focus on strategic partnerships with quality developers; and

(4) The investment manager shall control designs, amenities, costs, and overall quality of construction projects;

5. Land

a. “Land” shall refer to undeveloped, vacant land intended for, and with the reasonable probability of obtaining zoning for apartment building development.

b. Investment objective is to acquire land intended for development of apartment properties.

c. Investment Criteria

(1) Locations will be selected from supply-constrained markets and strategic in-fill locations within the sub-markets of existing assets accommodating growth;

(2) Entitlements are defined as land acquisitions that meet the following criteria:

(a) Zoned for apartment development;

(b) Free of governmental restrictions to apartment development (including, but not limited to, no-growth initiatives, building moratoriums and conflicts with general plan amendments); and

(c) Reasonably expected to receive site plan approval in the ordinary course of business.

(3) Environmental compliance is met when a satisfactory Phase I environmental report completed prior to land acquisition;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 8.0%; and

(5) Each property shall produce an appropriate risk adjusted return.

C. Bond-financed Apartments

1. General Requirements

Any investment in bond-financed apartment projects shall conform to the System's general criteria for apartment investments. This applies to both existing projects and development projects.

2. Leverage

Due to the peculiar nature of bond-financed apartment projects, the System places no limit on the amount of leverage used at the project level. However, in no event shall the debt exceed 100% of the value of the underlying real estate at time of acquisition.

3. Asset Management

The System shall require that asset management of bond-financed apartment projects is consistent with the requirements for conventional apartment projects.

VI. GENERAL

A. Unless otherwise noted, investors, managers, consultants, partners, members or other participants selected by the System shall base all calculations and computations on Fair Market Value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation for accounting purposes. See Statement of Investment Policy for Equity Real Estate Appraisal and Valuation.

B. Terms in this policy are defined in a master glossary of terms.

VII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms is referenced in the System's Master Glossary of Terms.